

Supplemental Letter of Findings: 02-20120554
Corporate Income Tax
For the Years 2008, 2009, 2010

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective as of its date of publication and remains in effect until the date it is suspended by the publication of another document in the Indiana Register.

ISSUE

I. Corporate Income Tax – Apportionment – Throwback Sales.

Authority: Public Law 86-272 (codified at 15 U.S.C. §381); IC § 6-3-2-2; [45 IAC 3.1-1-38](#); IC § 6-8.1-5-1; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); [45 IAC 3.1-1-64](#); Letter of Findings 04-20120544; Multistate Tax Compact Art. IV.3 (1967); Multistate Tax Compact Allocation and Apportionment Regulation, Reg. IV.3 (1973); Tenn. Code Ann. § 67-4-2007; Tenn. Code Ann. § 67-4-2104; Miss. Code Ann. § 27-7-5; Miss. Code Ann. § 27-7-15; Miss. Code Ann. § 27-13-7(1); Mo. Rev. Stat. § 143.071.2; Mo. Rev. Stat. § 143.111; Mo. Rev. Stat. §147.010.

Taxpayer protests the proposed assessment of additional income tax related to the "throwback" to Indiana of sales originating from Indiana to purchasers in Mississippi, Missouri, and Tennessee.

STATEMENT OF FACTS

Taxpayer is a plastics manufacturer with facilities in Indiana. Taxpayer sells its products to destinations throughout North America.

A review by the Indiana Department of Revenue ("Department") of Taxpayer's federal and state income tax returns for the years 2008 through 2010 and supporting information revealed several areas of non-compliance relating to the calculation of Taxpayer's Indiana corporate income tax. The Department made several adjustments to the calculation of Taxpayer's Indiana corporate income tax. The Department included the throwback to Indiana of sales destined to several other states, because the Department found that Taxpayer's activities in those states did not exceed the protection of P.L. 86-272.

Taxpayer protested the adjustment made by the Department to Taxpayer's "Indiana receipts factor" as it related to sales destined to Mississippi, Missouri, and Tennessee as well as associated penalties. An administrative hearing was held and a Letter of Findings, 02-20120554.LOF (the "Letter of Findings"), was issued on April 30, 2013, sustaining Taxpayer on its protest of the assessment of penalty, but otherwise denying Taxpayer's protest. Taxpayer requested a rehearing on its protest and presented additional documentation to support that request. A rehearing was granted and held. This Supplemental Letter of Findings ensues. Further facts will be provided as needed.

I. Corporate Income Tax – Apportionment – Throwback Sales.

DISCUSSION

For purposes of this Supplemental Letter of Findings ("Supplemental"), Letter of Findings 04-20120544 is incorporated by reference. This Supplemental will refer only to the issues raised on rehearing.

As a threshold issue, although a statute that imposes a tax is strictly construed against the State, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid and the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

The Department determined that, for purposes of calculating Taxpayer's Indiana tax liability, the receipts from sales to out-of-state customers should be thrown back to Indiana because the sales were made within jurisdictions where Taxpayer did not have nexus with the state for tax filing purposes. The audit based its decision on [45 IAC 3.1-1-50](#) and instructions included on the state return that attribute those sales to Indiana if the taxpayer is not taxable in the state of the purchaser and the sale is attributed to Indiana if the property is shipped from Indiana. Such sales are designated as "throwback" sales. Id.

The basic rule is found at IC § 6-3-2-2. IC § 6-3-2-2(e) provides that "sales of tangible personal property are in this state if . . . (2) the property is shipped from an office, a store, a warehouse, a factory, or other place of storage in this state and . . . (B) the taxpayer is not taxable in the state of the purchaser." IC § 6-3-2-2(n) provides that "[f]or purposes of allocation and apportionment of income under this article, a taxpayer is taxable in another state if: (1) in that state the taxpayer is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax; or (2) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not."

Therefore, in order to properly attribute income to a foreign state, Taxpayer must show either (1) that one of the taxes listed in IC § 6-3-2-2(n)(1) (a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax) has been levied against it; or (2) per IC § 6-3-2-2(n)(2) that the state has the jurisdiction to impose a net income tax against it regardless of "whether, in

fact, the state does or does not."

As explained in the Letter of Findings, Taxpayer asserted that during the years at issue it had nexus in Mississippi, Missouri, and Tennessee, and, therefore, the throwback rule was not applicable to the sales that were made to purchasers in those states. Taxpayer maintained that the following activities exceeded the protections of P.L. 86-272:

- (1) Designing and facilitating product development
- (2) Quality control assessments at the customer location
- (3) Resolving quality control issues at the customer locations.

Taxpayer argued in its October 9, 2012, protest letter that the above activities "performed in Mississippi, Missouri, and Tennessee suggests sufficient historic and future contacts requiring corporate income tax or franchise tax reporting obligations."

The Department's audit summary report states that Taxpayer made the same argument during the Department's audit investigation. During the audit, the Department requested that Taxpayer provide documentation for all audit years to support Taxpayer's throwback contentions. The taxpayer provided minimal documentation (three expense reports) to establish that employees were performing activities not protected by P.L. 86-272 in numerous states. However, the information provided did not prove Taxpayer went beyond mere solicitation in these states.

In its protest letter dated October 9, 2012, and during the hearing, Taxpayer indicated that it was in the process of entering into voluntary disclosure agreements ("VDAs") with the tax collection agencies of Mississippi, Missouri, and Tennessee whereupon Taxpayer would file and pay corporate income or franchise taxes in those states. Subsequent to the hearing, Taxpayer provided – unsigned – copies of these returns. Taxpayer did not provide copies of the VDAs, nor did Taxpayer provide further documentation and explanation of the activities it claimed provided sufficient nexus with Mississippi, Missouri, and Tennessee. Taxpayer stated that several years prior to the audit years, Taxpayer engaged a consultant to do a "nexus review" of its activities. Taxpayer stated it had difficulty finding the underlying data relating to the nexus activities because the employee who handled the "nexus review" was no longer with the company.

Taxpayer argued in its protest letter dated October 9, 2012, that Taxpayer "determined that it likely had nexus in several states, including Mississippi, Missouri, and Tennessee through the activities of its engineers and plant employees responsible for quality control." (Emphasis added). Taxpayer continued, "Such activities could include designing and facilitating product development as well as performing quality control assessments and conducting other quality control activities at the customer location." (Emphasis added). Taxpayer contended that "while the regularity of the travel varies depending upon the year, the frequency of these travel activities in recent years suggests the establishment of substantial nexus with Mississippi, Missouri, and Tennessee for corporate income tax and franchise tax purposes."

The April 30, 2013 Letter of Findings found that absent additional documentation by Taxpayer of its claimed activities in these other states – and especially in light of the voluntary nature of Taxpayer's VDAs with these other states – the Department could not agree with Taxpayer's contention that sales previously thrown back to Indiana by Taxpayer were no longer attributable to Indiana. In order for Taxpayer to meet its burden in protesting this assessment of Indiana tax, more was required than Taxpayer's say-so.

On rehearing Taxpayer continues to maintain that the Department's audit assessment overlooked the nexus and taxation of Taxpayer in states where Taxpayer was "taxable in another state."

[45 IAC 3.1-1-64](#), in relevant part, explains when a taxpayer is "taxable in another state":

"Taxable in Another State" Defined. A corporation is **"taxable in another state"** under the Act **when such state has jurisdiction to subject it to a net income tax. This test applies if the taxpayer's business activities are sufficient to give the state jurisdiction to impose a net income tax under the Constitution and statutes of the United States. Jurisdiction to tax is not present where the state is prohibited from imposing the tax by reason of the provision of Public Law 86-272, 15 U.S.C.A. §381-385.**

(Emphasis added).

15 U.S.C. § 381(a) establishes minimum standards for a state to impose tax and states, in relevant part, that: **No State**, or political subdivision thereof, **shall have power to impose**, for any taxable year ending after September 14, 1959, **a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:**

- (1) the **solicitation of orders** by such person, or his representative, in such State for sales of tangible personal property, **which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and**
- (2) the **solicitation of orders** by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, **if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).**

(Emphasis added).

15 U.S.C. § 381(c) further provides:

Sales or solicitation of orders for sales by independent contractors

For purposes of subsection (a) of this section, **a person shall not be considered to have engaged in business activities within a State during any taxable year merely by reason of sales in such State, or the solicitation of orders for sales in such State, of tangible personal property on behalf of such person by one or more independent contractors, or by reason of the maintenance, of an office in such State by one or more independent contractors whose activities on behalf of such person in such State consist solely of making sales, or soliciting orders for sales, of tangible personal property.**

(Emphasis added).

In other words, the throwback rule is a backup for the "destination rule" when the "destination rule" assigns a sale to a state that cannot tax that sale (because of P.L. 86-272), the sale is reassigned back to the state that is the source of the sale. Accordingly, in every transaction, at least one state has the authority to impose tax on income derived from the sale of tangible personal property. A state may impose tax on a taxpayer only when the taxpayer's activity within the state exceeds "solicitation."

Accordingly, the claim that it is "taxable in another state" because it is "subject to a net income tax, a franchise tax measured by net income, [or] a franchise tax for the privilege of doing business" in that state, a taxpayer must demonstrate that the statutory requirements are satisfied: (1) the taxpayer is actually doing business in the state, and (2) the taxpayer is subject to tax in that state. IC § 6-3-2-2(n).

"For apportionment purposes, a taxpayer is doing business in a state if it operates a business enterprise or activity in such state." [45 IAC 3.1-1-38](#). Specifically, [45 IAC 3.1-1-38](#) provides seven (7) categories illustrating what is considered as "doing business in a state."

The Letter of Findings referred to the Multistate Tax Committee ("MTC") model regulations on throwback sales to assert the point that Taxpayer had to show that it did business in another state and that its activities in that state provided tax nexus (in other words, its activities exceed the "mere solicitation" protection of P.L. 86-272). The MTC model regulations also state that when a taxpayer voluntarily files a return in a state for the privilege of doing business, simply filing the return and/or paying such tax are not sufficient to determine whether the taxpayer is subject to the state franchise tax for the privilege of doing business in that state and, therefore, taxable in that state. A taxpayer has to demonstrate that it actually "engage[s] in some business activity" and "the minimum tax bears a relationship to the taxpayer's business activity within such state." MTC Art. IV.3 (1967) and MTC Allocation and Apportionment Regulation IV.3.(1) (1973).

In its request for rehearing, Taxpayer objected to the reference in the Letter of Findings to the MTC's standard as authority for Indiana tax analysis because Indiana is not a member of the MTC compact nor has it adopted the MTC's model regulation. The Department clarifies that while the MTC's standard is not binding on Indiana for the reasons Taxpayer mentions, nonetheless, the referenced model regulation offers guidance on how to approach analysis of the facts relating to these types of "throwback" issues. The reference to the MTC standard is merely to point out that more is required of Taxpayer when it voluntarily steps forward with a claim for tax nexus when it had previously thrown back its sales to Indiana. The MTC model throwback regulation underlines the purpose to which the throwback rules are directed.

In the course of its request for rehearing, Taxpayer presented signed tax returns for each of the contested states and the VDAs with those states. These tax returns are for income and/or franchise taxes for each of the states. Taxpayer also presented a report that shows that Taxpayer's parent reported tax to Mississippi and withheld state tax on wages of an employee. Taxpayer also presented lists of its employees' hotel stays and car rentals in each of the three states. These lists consist of the names of the employees, the hotels or car rental agencies where the stays or rentals took place, and the dates of the stays or rentals (typically one or two days). Taxpayer did not present documentation that shows what these employees were doing in the states. What the employees were doing is important; if they were only soliciting sales (and attendant activities) and the tax that the Taxpayer says it is subject to in those states is one based on income, then those activities fall under P.L. 86-272 and do not subject Taxpayer to nexus. Taxpayer would not be "subject to tax in another state." If Taxpayer does not have nexus with a state for income tax purposes, then the receipts related to its sales in those states from Indiana get "thrown back" to Indiana. On the other hand, if Taxpayer's activities in those states go beyond the protection of P.L. 86-272, then Taxpayer would indeed have nexus with those states for income tax purposes or for purposes of a franchise tax based on net income, and the receipts relating to its sales in those states from Indiana would be reported as income to Taxpayer from that state and not "thrown back" on Taxpayer's Indiana income tax returns.

What follows is a review of the documentation Taxpayer presented for each of the states in support of its protest on rehearing:

Tennessee

Taxpayer presented "Franchise/Excise Tax" returns ("FAE 170") for Tennessee for purposes of the VDA with Tennessee for periods that cover Indiana's audit periods. The FAE 170 return form is for both Tennessee franchise and excise taxes. There was no property or payroll reported in Tennessee for these periods. The

returns report income from sales in Tennessee because Tennessee was the destination of these sales. In all but one of the years at issue, Taxpayer reported, and according to the signed VDAs, paid both franchise and excise tax to Tennessee.

The Tennessee excise tax is imposed on the privilege of doing business in Tennessee and is based on net earnings or income (general partnerships and sole proprietorships are not subject to the tax). Tenn. Code Ann. § 67-4-2007.

The Tennessee franchise tax is levied upon the privilege of doing business in Tennessee and is based on the greater of net worth or the book value of real or tangible personal property owned or used in Tennessee. Tenn. Code Ann. § 67-4-2104.

As discussed previously, under IC § 6-3-2-2(n)(1) "a taxpayer is taxable in another state if . . . in that state the taxpayer is subject to . . . a franchise tax for the privilege of doing business." Thus, to claim that it is taxable in another state because it is "subject to a franchise tax for the privilege of doing business" in that state, a taxpayer must demonstrate the statutory requirements are satisfied: (1) the taxpayer is actually doing business in that state; (2) the taxpayer is subject to a franchise tax in that state, which is imposed for the privilege of doing business in that state; namely, the tax is imposed in connection with the taxpayer's business enterprise or activities in that state. IC § 6-3-2-2(n).

"For apportionment purposes, a taxpayer is doing business in a state if it operates a business enterprise or activity in such state." [45 IAC 3.1-1-38](#). Specifically, [45 IAC 3.1-1-38](#) provides seven (7) categories illustrating what is considered as "doing business in a state." However, when a tax is not classified as "net income tax" or is not based upon or measured by "net income," then P.L. 86-272 does not apply.

Taxpayer's documentation demonstrated that Taxpayer conducted business activity in Tennessee and the FAE 170s show that franchise taxes were filed and that the taxes imposed connected to Taxpayer's business activities in Tennessee. Accordingly, Taxpayer's protest to the imposition of tax resulting from Taxpayer sales to Tennessee for the periods beginning October 1, 2008 through the period ending September 30, 2011, being thrown back to Indiana is sustained. These are the periods for which Taxpayer presented FAE 170s.

This Supplemental Letter of Findings does not reach the Indiana throwback of Taxpayer's Tennessee sales as it relates to Tennessee excise tax nexus. This Supplemental does not need to reach that issue given Taxpayer's nexus with Tennessee for franchise tax purposes.

Accordingly, Taxpayer's protest of the Department's imposition of tax resulting from the throwback to Indiana of sales to Tennessee is sustained.

Mississippi

Taxpayer presented "Corporate Income and Franchise Tax" returns for Mississippi for purposes of the VDA with Mississippi for periods that cover Indiana's audit periods. The tax form is for both the Mississippi income and franchise taxes. There was no property or payroll reported in Mississippi for these periods. The returns report income from sales in Mississippi; i.e., Mississippi was the destination of these sales. In all the years at issue, Taxpayer reported, and according to the signed VDAs, paid both income and franchise tax to Mississippi *[sic]*.

Mississippi income tax is imposed as follows: Miss. Code Ann. § 27-7-5 imposes a state income tax based on net income as defined under Miss. Code Ann. § 27-7-15.

Mississippi also imposes a franchise tax for the privilege of doing business in that state. Miss. Code Ann. § 27-13-7(1), which states:

(1) Franchise tax levy. Except as otherwise provided in subsections (3), (4), (5) and (7) of this section, there is hereby imposed, levied and assessed upon every corporation, association or joint-stock company, or partnership treated as a corporation under the Income Tax Laws or regulations as hereinbefore defined, organized and existing under and by virtue of the laws of some other state, territory or country, or organized and existing without any specific statutory authority, now or hereafter doing business or exercising any power, privilege or right within this state, as hereinbefore defined, a franchise or excise tax equal to Two Dollars and Fifty Cents (\$ 2.50) of each One Thousand Dollars (\$ 1,000.00), or fraction thereof, of the value of capital used, invested or employed within this state, except as hereinafter provided. In no case shall the franchise tax due for the accounting period be less than Twenty-five Dollars (\$ 25.00). It is the purpose of this section to require the payment of a tax by all organizations not organized under the laws of this state, measured by the amount of capital or its equivalent, for which such organization receives the benefit and protection of the government and laws of the state.

Therefore, the Mississippi franchise tax is computed based on the value of the capital employed or the assessed property values in Mississippi, whichever is greater.

Taxpayer also presented a report that shows that Taxpayer's parent reported to Mississippi and withheld state tax on wages of an employee. This document, however, does not on its face relate to Taxpayer, but to Taxpayer's parent. No additional information regarding the nature of this employee's employment affiliation and activities in Mississippi was presented.

As discussed previously, under IC § 6-3-2-2(n)(1) "a taxpayer is taxable in another state if . . . in that state the taxpayer is subject to . . . a franchise tax for the privilege of doing business." Thus, to claim that it is taxable in another state because it is "subject to a franchise tax for the privilege of doing business" in that state, a taxpayer

must demonstrate the statutory requirements are satisfied: (1) the taxpayer is actually doing business in that state; (2) the taxpayer is subject to a franchise tax in that state, which is imposed on the taxpayer for the privilege of doing business in that state; namely, the tax is imposed in connection with the taxpayer's business enterprise or activities in that state. IC § 6-3-2-2(n).

"For apportionment purposes, a taxpayer is doing business in a state if it operates a business enterprise or activity in such state." [45 IAC 3.1-1-38](#). Specifically, [45 IAC 3.1-1-38](#) provides seven (7) categories illustrating what is considered as "doing business in a state." However, when a tax is not classified as "net income tax" or is not based upon or measured by "net income," then P.L. 86-272 does not apply.

Taxpayer's documentation demonstrated that Taxpayer conducted business in Mississippi and the returns show that franchise taxes "for the privilege of doing business" in Mississippi were filed and that the taxes imposed were in connection to Taxpayer's business activities in Mississippi. Accordingly, Taxpayer's protest to the imposition of tax resulting from Taxpayer sales to Mississippi for the periods beginning October 1, 2008, through the period ending September 30, 2011, being thrown back to Indiana is sustained. These are the periods for which Taxpayer presented Mississippi income tax and franchise returns.

This Supplemental Letter of Findings does not reach the Indiana throwback of Taxpayer's Mississippi sales as it relates to Mississippi income tax nexus. This Supplemental does not need to reach that issue given Taxpayer's nexus with Mississippi for franchise tax purposes.

Accordingly, Taxpayer's protest of the Department's imposition of tax resulting from the throwback to Indiana of sales to Mississippi is sustained.

Missouri

Taxpayer presented "Corporate Income and Franchise Tax" (Forms MO-1120) returns for Missouri for purposes of the VDA with Missouri for periods that cover Indiana's audit periods. The return form is for both the Missouri income and franchise taxes. There was no property or payroll reported in Missouri for these periods. The returns report income from sales in Missouri because Missouri was the destination of these sales originating outside Missouri. In all of the years at issue, Taxpayer reported and paid income tax to Missouri, but no franchise tax.

Section Mo. Rev. Stat. § 143.071.2 imposes an income tax on Missouri taxable income, which is Missouri adjusted gross income with certain modifications; Mo. Rev. Stat. § 143.111. Mo. Rev. Stat. § 143.121 defines Missouri adjusted gross income tax and starts with income reported on the federal return with certain Missouri specific adjustments.

The Missouri franchise tax is imposed on a percentage of the par value of a taxpayer's outstanding shares with certain conditions for the "privilege of doing business" in Missouri. Mo. Rev. Stat. §147.010. However, if a corporation has assets or apportioned assets of \$10,000,000 or less, it is not subject to Missouri franchise tax and must so indicate on the MO-1120. Taxpayer so indicated on each of the Missouri returns it submitted for the periods at issue; i.e., Taxpayer checked the box on each of the returns to state that its assets apportioned to Missouri did not exceed \$10,000,000. Taxpayer was therefore not subject to the franchise tax in Missouri for those periods.

As discussed previously, under IC § 6-3-2-2(n)(1) "a taxpayer is taxable in another state if . . . in that state the taxpayer is subject to . . . a franchise tax for the privilege of doing business." Thus, to claim that it is taxable in another state because it is "subject to a franchise tax for the privilege of doing business" in that state, a taxpayer must demonstrate the statutory requirements are satisfied: (1) the taxpayer is actually doing business in that state; (2) the taxpayer is subject to a franchise tax in that state, which is imposed on the taxpayer for the privilege of doing business in that state; namely, the tax is imposed in connection with the taxpayer's business enterprise or activities in that state. IC § 6-3-2-2(n).

"For apportionment purposes, a taxpayer is doing business in a state if it operates a business enterprise or activity in such state." [45 IAC 3.1-1-38](#). Specifically, [45 IAC 3.1-1-38](#) provides seven (7) categories illustrating what is considered as "doing business in a state." However, when a tax is not classified as "net income tax" or is not based upon or measured by "net income," then P.L. 86-272 does not apply.

Because the only tax that Taxpayer reported to Missouri for the periods at issue was income tax, a closer look at Taxpayer's activities in Missouri is warranted in order to determine if Taxpayer's activities in Missouri exceeded the protection of P.L. 86-272. Again, there was no property or payroll reported in Missouri for these periods. The returns show income from sales in Missouri – Missouri was the destination of these sales originating outside Missouri – based upon which Taxpayer's Missouri apportionment percentage was determined. None of the other documentation Taxpayer presented (the hotel stays and car rental reports) identify the purpose of its employees' temporary stays in Missouri. There is no documentation that asserts that these business trips were for anything other than the solicitation of sales and attendant activities falling under the protections of P.L. 86-272. Indeed, Taxpayer did not, during the audit or protest, substantiate any of the activities in which it claimed it had engaged.

Accordingly, Taxpayer has not met its burden to show that its protest of the Department's imposition of tax resulting from the throwback to Indiana of sales to Missouri is justified. Therefore, Taxpayer's protest of the Department's imposition of tax resulting from the throwback to Indiana of sales to Missouri is denied.

FINDING

Taxpayer's protest is sustained as it pertains to the throwback sales relating to Tennessee and Mississippi, but denied as it pertains to the throwback sales relating to Missouri.

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